IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NO. .....

WASHINGTON COUNTY FIRE INSURANCE COMPANY, Washington, Pennsylvania, Petitioner,

v.

WILLIAM DRISCOLL, Collector of Internal Revenue, 23rd District of Pennsylvania, Pittsburgh, Pennsylvania, Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions of the Courts Below.

The opinion of the United States District Court for the Western District of Pennsylvania may be found in 28 Fed. Supp. 224, and also in the Record at R. 61.

The opinion of the United States Circuit Court of Appeals for the Third Circuit may be found in 110 Fed. (2d) 485, and also in the Record at R. 82.

II.

Jurisdiction.

Since the jurisdiction of this Court has been set forth in the petition, it is believed unnecessary to restate it here.

III.

Statement of the Case.

Since the facts and circumstances have been stated in the petition, it is believed unnecessary to restate them here.

IV.

Specification of Errors to Be Urged.

1. The Circuit Court of Appeals erred in reviving, for use in and as a basis of its opinion, the dead provisions of a repealed state statute.

2. The Circuit Court of Appeals erred in exercising an absolute right of revision of the findings of fact of the District Court.

3. The Circuit Court of Appeals erred in holding that petitioner was not entitled to exemption as a mutual fire insurance company within the meaning of Section 103 (11) of the Revenue Acts of 1928 and 1932 and Section 101 (11) of the Revenue Acts of 1934 and 1936.

4. The Circuit Court of Appeals erred in not holding that the income of petitioner was used or held for the purpose of paying losses or expenses.

5. The Circuit Court of Appeals erred in reversing the judgment of the District Court and in entering judgment for respondent.

V.

Argument.

Summary.

Where a circuit court itself fixes a definite amount as the maximum surplus that can be unqualifiedly held by a mutual fire insurance company without being subjected to the charge of abuse of legal discretion, it has indulged in judicial legislation. It is beyond the reach of a circuit court to exercise an absolute right of review of the findings of fact of a district court. In these circumstances alone, the decision of the Circuit Court of Appeals should not be allowed to stand. The remaining grounds upon which the decision of the Circuit Court is based are probably untenable. Congress specified for exemption a type of fire insurance company which is not necessarily a pure mutual fire insurance company. A *de facto* trusteeship, such as petitioner, may qualify for exemption as a mutual fire insurance association.

Point I.

Where a Circuit Court of Appeals Revives, For Use In and As a Basis Of Its Opinion, the Dead Provisions of a Repealed State Statute, It Has Indulged in Judicial Legislation in Violation of the Constitution.

In determining whether petitioner met the second requirement for exemption, viz., the "purpose" of using or holding its income, the Circuit Court concluded that because the surplus of petitioner "far exceeds this sum" of $250,000 and because no redundancy certificates had been issued and/or paid, its surplus undoubtedly must have been held—not to pay losses or expenses for the benefit of the policyholders but, on the contrary, for the benefit of 16 deposit note makers.

Concededly, a mutual company is one in which the surplus is held for the benefit of its policyholders exclusively. It would seem, then, that the Circuit Court came to the conclusion that petitioner did not meet either the first or the second requirement for exemption because its surplus is not held for the benefit of its policyholders, that its surplus is not held for the benefit of its policyholders because its surplus is held for the benefit of its deposit note makers, and that its surplus is held for the benefit of its deposit note makers because it abused its discretion in not issuing and/or redeeming certificates of proportionate shares in accordance with the provisions of the repealed Pennsylvania Act of 1856.

We believe that this conclusion is based upon judicial legislation and should not be allowed to stand, as in violation of Section 1, Article I, of the Constitution and the due process clause of the Fifth Amendment.

In *Home Building & Loan Association v. Blaisdell,* 290 U. S. 398, 447, 54 S. Ct. 231, 243, this Court said:

> "Whether the legislation is wise or unwise as a matter of policy is a question with which we are not concerned."

To the same effect are the decisions of this Court in *Wayman v. Southard,* 10 Wheat, 1, 46; *License Tax Cases,* 5 Wall. 462, 469; and *Prentis v. Atlantic Coast Line Company,* 211 U. S. 210, 226, 29 S. Ct. 67, 69.

We believe that there is no sense of justice in the judicial selection of the figure of $250,000, relatively small and possibly inadequate, in view of petitioner's outstanding $10,000,000 insurance liability and in view of the well-known enormous increase in the concentration of insurance hazards since the year 1856.

POINT II.

Where a Circuit Court of Appeals Exercises an Absolute Right of Review of the Findings of Fact of a District Court, It Disregards a Rule Long and Firmly Established in Our System of Administering Justice.

The question of the sufficiency of the evidence to support the findings of fact of the trial court is a preliminary question of law reviewable by an appellate court. This question of law, however, should be expressly decided by the appellate court if such findings are reversed, for without an expressed decision on this question of law, such reversal would appear to be based upon a mere disagreement with the lower court as to the weight of the evidence and, if this were the fact, then the appellate court would be constituting itself the trier of facts. Such action would not be due process of law within the meaning of the Fifth Amendment to the Constitution.

In the following instances the Circuit Court reversed the findings of fact of the District Court apparently upon a mere disagreement as to the weight of the evidence:

(1) The District Court found that the income of petitioner "was not used or held for the purpose of paying dividends" and "was used or held for the purpose of paying losses or expenses" (R. 68). The Circuit Court found that the surplus of petitioner was "held for the benefit of the members" (i. e. 16 deposit note makers). The Circuit Court's holding is a reversal of the findings of the District Court for, if petitioner's surplus was held for the benefit of deposit note makers, obviously it was not held for the benefit of paying losses or expenses. There was ample evidence to support the findings of fact of the District Court (R. 47, 52, 53).

(2) The District Court found that "from January 19, 1914, to the present time rated property and unrated

property have been insured for a single consideration, viz., an annual cash premium payable in advance" (R. 63). The Circuit Court found that petitioner has carried on a nonmutual business since that date because it insures property "for a cash premium" and also insures property "for the consideration of a deposit note" (R. 90). The Circuit Court's holding is a reversal of the findings of the District Court for, if all types of property have been insured since January, 1914, for a "single" consideration, it is obvious that there has been no insurance issued for two or more different kinds of considerations. There was ample evidence to support the findings of fact of the District Court (R. 14, 15).

(3) The District Court found that petitioner "has written in each case only one kind of insurance, viz., term insurance for periods ranging from thirty days to five years, and whether the applicant has or has not signed and delivered to plaintiff a deposit note" and that petitioner "has operated in each case since January, 1914, upon the annual cash premium basis, payable in advance, and this is true whether a policyholder has or has not signed and delivered a deposit note" (R. 67, 68). The Circuit Court found that there were two classes of members, each class receiving insurance "under different conditions" (R. 90). Obviously, where "only one kind" of insurance is issued and paid for "in each case" upon the annual cash premium basis and "whether * * * * * * or not" a deposit note has been signed, insurance has not been received by one class of persons under conditions different from another class of persons. All insurance has therefore been issued regardless of notes. To hold that in such circumstances insurance has been received by different classes of persons under different conditions, is a reversal of the findings of fact of the District Court. There was ample evidence to support the findings of fact of the District Court (R. 19).

The above-mentioned facts are not only material to a judgment in this case, but appear to be the very gist of the case. If it be true that the Circuit Court exercised an absolute right of review of these essential facts, then the decision of the Circuit Court should not be allowed to stand, upon the authority of the following cases:

In the case of *Dooley v. Pease,* 180 U. S. 126, 131, 21 S. Ct. 329, 331, this Court said:

> "Errors alleged in the findings of the court are not subject to revision by the Circuit Court of Appeals, or by this court, if there was any evidence upon which such findings could be made."

To the same effect are the decisions of this Court in *Stanley v. Supervisors of Albany,* 121 U. S. 535, 547, 7. S. Ct. 1234, 1237, and *Hathaway v. Cambridge National Bank,* 134 U. S. 494, 498, 10 S. Ct. 608, 610.

And the Third Circuit Court of Appeals itself has held the same way in the case of *Washington & Canonsburg Railway Co. v. Murray,* 211 Fed. 440, 447, where that court said:

> "Where, as here, a case is tried by a judge, the findings of fact by a court are conclusive, unless there was no evidence to support them."

The rule that an appellate court cannot review the findings of fact of a trial court should work both ways. Here, the Circuit Court appears to have exercised an absolute right of review in disregard of the long and firmly established rule. The disregard of such a rule of procedure could hardly be due process of law. Probably it would be well for this Court again to announce this long and firmly established rule and to point out that the rule should work both ways.

POINT III.

Congress Did Not Intend To Exempt a Pure Mutual Fire Insurance Company As Such.

The Circuit Court held (R. 90) that petitioner operated on a "strictly" mutual basis from 1873 to 1911, but thereafter did not operate "as a mutual". It did not appear to consider the reason why Congress added a proviso to the word "mutual", nor did it appear to pass upon the question of whether a strict or pure mutual alone was intended for exemption. It would seem that the Circuit Court took it for granted that Congress intended to exempt only pure mutuals.

Congress has provided that to be exempt a company must be mutual and also must use "or" hold its income to pay losses or expenses. The word "income" was not limited by Congress and therefore includes income from premiums as well as income from investments. A pure mutual should not hold its redundancy but should return it to policyholders. If it does not return redundancy, it is of course not a pure mutual.

In *Penn Mutual Life Insurance Company v. Lederer*, 252 U. S. 523, 525, 40 St. Ct. 397, 398, Mr. Justice Brandeis said:

> "It is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder."

And yet Congress has said that a company may hold its income (from all sources), which means that it need not return redundancy.

Petitioner is not a strict mutual because it has never engaged in the practice of returning redundancy, but that course of conduct is compatible with the idea of

exemption. When Congress provided that income could either be used "or held" to pay losses or expenses, it gave an option or election to a company to retain or not to retain redundancy. Also, it was not discriminating against strong, in favor of weak, protection for it approved holding income—which means building up a surplus.

When a company engages in the practice of paying dividends—as distinguished from returning redundancy —to policyholders, and paying these dividends out of income from investments, it is being operated with a view to private gain, is not using or holding its income to pay losses or expenses, and obviously is not exempt.

In *McLaughlin v. Philadelphia Contributionship for Insurance of Houses from Loss by Fire,* 73 Fed. (2d) 582, 584 (certiorari denied 294 U. S. 718, 55 S. Ct. 544), it appeared that the company claiming exemption (under similar statutory provisions) had paid dividends. In denying exemption to that company even though it was considered to be a strict mutual, the Third Circuit Court of Appeals said:

(P. 582) "The plaintiff is a mutual fire insurance company largely doing business in Philadelphia."

* * * * * * *

(P. 584) "The findings of the District Court show plainly that the plaintiff's income was used and held, not only for paying its losses and expenses, but for investment for the benefit of its members. Since 1895, the plaintiff has distributed annually to those who have held policies for ten years and more sums equal to 10 per cent. of their premium deposits.

* * * * * * *

"It is not the type of mutual company intended to be exempt from taxation."

Indeed, pure mutual fire insurance companies, as such, are subject to income tax. See Section 208, Revenue Act of 1928, in Appendix, P. 29. It is only when a mutual fire insurance company uses or holds its income for the purpose of paying losses or expenses that it is exempt. It is believed that to limit exemption to pure mutuals is an untenable ground.

Congress intended to exempt from income taxation a mutual fire insurance company which is not operated for private gain but is operated for the purpose of paying losses or expenses. An examination of all of the seventeen paragraphs of Section 103 of the Revenue Act of 1928 (Appendix, P. 25) demonstrates that Congress felt that there are certain kinds of organizations which actually receive income but which do not operate for the purpose of making an income which "inures to the benefit of any private shareholder or individual", but which operate for the purpose of making an income to be used "or held" for the *common education, comfort or protection* of those interested therein. Such kind of organization, not being operated for private gain, is exempt from income taxation because the idea of income taxation is based fundamentally upon the receipt of private gain or profit. The dividends of such corporations and organizations are in kind and not in cash. Not all cemetery companies, for instance, are exempt, but only that type of cemetery company the income of which does not inure to the benefit of any private shareholder or individual. (See paragraph (5), Appendix, P. 25).

POINT IV.

A De Facto Trusteeship May Qualify For Exemption as a Mutual Fire Insurance Association.

In the Stipulation of Facts filed in the District Court the parties agreed that only those persons executing deposit notes are members (R. 15), but the District Court felt that it could not give full indorsement to this fact, as full indorsement would mean acceptance of a conclusion deemed contrary to law (R. 74). The District Court found (R. 69) that each policyholder is a member of petitioner while his policy is in force, that there were not two or more classes of policyholders, that the deposit note makers were not the owners of petitioner, and that the policyholders constituted the only group of persons really interested in petitioner. The charter of petitioner provided (R. 20) that the business of petitioner "shall" be transacted upon the "mutual principle, exclusively" and that petitioner is "allowed" to insure on the cash or annual premium system, but that "insurance thus effected shall not entitle the insured to membership". In commenting upon the denial of membership to policyholders who paid for their insurance upon the cash premium system, the District Court felt that this denial was "not easily explainable" (R. 73) as it was directly contrary to the provisions of Section 11 of the Pennsylvania Act of April 2, 1856, P. L. 211, which provided among other things that "all persons insured with, and continuing to be insured therein, shall thereby become members during the period they shall remain so insured and no longer, * * *". The District Court held that the denial of membership by the chartering court was "beyond its power and therefore ineffective" (R. 73). The chartering court probably never expected petitioner to completely abolish deposit notes as a consideration for the issuance of insurance; otherwise it probably would not have denied formal member-

ship to policyholders under the exclusive cash premium system.

The Circuit Court of Appeals, however, felt that only deposit note makers were members because petitioner's charter, by-laws and the Stipulation of Facts said so (R. 90).

If there had really been more than one class of policyholders, petitioner obviously would not be a mutual company. In the case of *Baltimore Equitable Society v. U. S.*, 3 F. Supp. 427, 432 (certiorari denied 290 U. S. 662, 54 S. Ct. 77), it apeared that the company had issued policies for term insurance as well as for perpetual insurance. The term insurance policyholders paid a fixed cash premium, had no voice in the management of the company and no right to share in the earnings. The perpetual insurance policyholders were subject to assessment, were entitled to share in the earnings and were entitled to a voice in the management. In such circumstances, the Court of Claims very properly held that "there was no mutuality".

The District Court felt (R. 71, 72) that in the idea that petitioner could be taken over by some 15 or 16 persons "each scratching his name to a meaningless piece of paper is surprising naivete". The Circuit Court seemed to stress title and self-government, as though only a corporate form of organization could qualify for exemption. It seems that petitioner did not sufficiently urge on the Circuit Court the difference between a policyholder, as such, and a deposit note maker, as such, especially after deposit notes were abolished as a consideration for the issuance of insurance. That one person could be a creditor (policyholder) and also a debtor (note maker) at the same time seemed to the Circuit Court to make for two classes of *policyholders,* one sub-

ject to assessment and the other not. A policyholder, as such, is never subject to assessment, for he pays for insurance—at least since January, 1914—upon only the annual cash premium basis.

To award the ownership of petitioner to the deposit note makers, who testified (R. 47, 48, 52) that the company was operated "for the protection of policyholders and the payment of losses" and that deposit notes have been issued since January, 1914, "simply to perpetuate the membership to manage the affairs of the company" and because "the charter provides this must be done", would amount to a gift neither sought nor expected and, indeed, contrary to their belief and intention.

The continued use since January, 1914, of deposit notes has not been an incident of or consideration for the issuance of insurance policies, but simply a necessary means, in the absence of amending the charter, of enabling petitioner to be managed and operated as a mutual according to the terms of its charter while employing the cash premium system exclusively. The Commissioner of Internal Revenue has ruled that the issuance of nonassessable policies exclusively does not destroy mutuality nor is it decisive of exemption (Appendix, P. 30).

Congress has not provided that to be exempt a mutual fire insurance company must be a corporation or some other *de jure* organization. It has used the words "companies or associations". A trusteeship created by act of the parties is an association.

There appears to be no valid reason why petitioner should not be considered at least a *de facto* trusteeship since January, 1914. A few individuals, who were policyholders, took it upon themselves to maintain a technical or formal membership. That is, they declared themselves trustees for the policyholders. Certainly,

the intention of the deposit note makers, according to their testimony, would point to an intention to operate—not for their own benefit but for the benefit of the policyholders. Trustees usually manage the affairs of a trusteeship. Trustees usually do the voting. There is a vast difference between control for one's own benefit and control for the benefit of another. A trustee cannot operate a trust for the trustee's benefit. A trustee has no interest in or equitable ownership of the trust assets. The duties performed by the deposit note makers are not incompatible with the usual duties of trustees. The policyholders are the real members of this company because beneficiaries are the real members of *any* trust. To award both the legal and beneficial interests in petitioner to 16 individuals (and the Circuit Court's decision is tantamount to such an award) would be unfair to the policyholders and unsought by those individuals. It would meet one's sense of justice to rule that since January, 1914, petitioner has been operated for the protection—not gain—of the policyholders exclusively, and that its 16 deposit note makers have been merely agents and trustees for the policyholders. Such a ruling would carry with it the conviction that petitioner is the type of organization intended to be exempt from an income tax which is levied, not on common protection, but on private gain and profit.

Respectfully submitted,

WILLIAM G. HEINER,
Counsel for Petitioner.

1321 Park Building,
Pittsburgh, Pennsylvania.